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Department of the Treasury  
Washington, DC 20224

Third Party Communication: None  
Date of Communication: Not Applicable

Person To Contact: \_\_\_\_\_, ID No. \_\_\_\_\_

Telephone Number:

Refer Reply To:  
CC:PSI:B01  
PLR-137909-09  
Date: October 29, 2009

**Legend:**

$$\underline{X} =$$
$$\underline{Y} =$$
$$\underline{Z} =$$

Date 1 =

Year 1 =State =a =**b** =C =d =
$$\underline{e} =$$

Dear :

This letter responds to your letter, on behalf of X, dated August 6, 2009, requesting a ruling that X's rental income from its rental activities is not passive investment income within the meaning of § 1362(d)(3)(C)(i) of the Internal Revenue Code.

## Facts

The information submitted states that X was formed on Date 1 in accordance with the laws of State. The members of X are trusts. Some of the members have multiple beneficiaries. Those beneficiaries intend to pour the trust assets over to new trusts. Thus, each member will be a trust with a single beneficiary. X also wholly owns a corporations (the Parent Corporations). The Parent Corporations wholly own b subsidiary corporations (the Subsidiary Corporations). X also owns c stand-alone corporations (the Stand-alone Corporations). The Subsidiary Corporations and Stand-alone Corporations hold real properties (the Properties) that are held for rent to tenants.

X intends to elect to be treated as an S corporation for federal income tax purposes. All members of X will elect to be treated as qualified subchapter S trusts (QSSTs). X intends to elect for the Parent and Subsidiary Corporations to be treated as qualified subchapter S subsidiaries (Qsubs) for federal income tax purposes. X also intends to elect to treat all of the Stand-alone corporations except Y as Qsubs.

The corporations for which the Qsub elections will be made have accumulated earnings and profits from prior years.

X has employees who directly perform services relating to the Properties from X's management office. X also contracts with a management company, Z, as its agent. X, through its employees or through Z, provides certain services with respect to the leasing of the Properties, including, but not limited to: hiring and dismissing employees that maintain and operate the Properties; approving and making expenditures to maintain the Properties; negotiating contracts for insurance, utilities, and other services; maintaining the Properties; listing the Properties for lease; approving leases and subleases; collecting rents; and handling complaints of tenants and subtenants.

In Year 1, X collected approximately \$d in gross rents and incurred approximately \$e in relevant operating expenses.

## Law and Analysis

Section 1361(a)(1) defines an "S corporation" as a small business corporation for which an election under § 1362(a) is in effect for the taxable year.

Section 1362(d)(3)(A)(i) provides that an S corporation election shall be terminated whenever the corporation (I) has accumulated earnings and profits at the close of each of 3 consecutive taxable years, and (II) has gross receipts for each of such taxable years more than 25 percent of which are passive investment income. The termination is effective on and after the first date of the first taxable year beginning after

the third consecutive taxable year referred to in § 1362(d)(3)(A)(i). Section 1362(d)(3)(A)(ii).

Except as otherwise provided in § 1362(d)(3)(C), § 1362(d)(3)(C)(i) provides that the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1375(a) imposes a tax on the income of an S corporation if the S corporation has (1) accumulated earnings and profits at the close of such taxable year, and (2) gross receipts more than 25 percent of which are passive investment income.

Section 1362(d)(3)(C)(i) provides that, except as otherwise provided, the term "passive investment income" means gross receipts derived from royalties, rents, dividends, interest, annuities, and sales or exchanges of stock or securities.

Section 1.1362-2(c)(5)(ii)(B)(1) defines "rent" as amounts received for the use of, or right to use, property (whether real or personal) of the corporation.

Section 1.1362-2(c)(5)(ii)(B)(2) provides that the term "rents" does not include rents derived in the active trade or business of renting property. Rents are derived in an active trade or business of renting property only if, based on all the facts and circumstances, the corporation provides significant services or incurs substantial costs in the rental business. Generally, significant services are not rendered and substantial costs are not incurred in connection with net leases. Whether significant services are performed or substantial costs are incurred in the rental business is determined based upon all the facts and circumstances including, but not limited to, the number of persons employed to provide the services and types and amounts of costs and expenses incurred (other than depreciation).

### Conclusion

Based solely on the facts and representations submitted, we conclude that the rental income that X derives from the Properties is not passive investment income as described in §1362(d)(3)(C)(i).

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed concerning whether X is a small business corporation eligible to make an S corporation election; whether the members of X are eligible to make an election to be treated as QSSTs; or whether the Parent, Subsidiary, and Stand-alone Corporations are eligible to make an election to be treated as Qsubs. Further, the passive investment income rules of § 1362 are completely independent of the passive activity rules of § 469; unless an exception under § 469 applies, the rental activity remains passive for purposes of § 469.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file with this office, a copy of this letter will be sent to the taxpayer's representative.

Sincerely,

*David R. Haglund*

David R. Haglund  
Acting Branch Chief, Branch 1  
Office of Associate Chief Counsel  
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

Copy of this letter for § 6110 purposes